Norwegian Cruise Line Holdings Ltd.
Form 10-Q
August 07, 2015

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

**FORM 10-Q**

**(Mark One)**

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the quarterly period ended June 30, 2015**

**OR**

.. **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the transition period from __________ to__________**

**Commission File Number: 001-35784**

**NORWEGIAN CRUISE LINE HOLDINGS LTD.**

**(Exact name of registrant as specified in its charter)**

| | |
|---|---|
| **Bermuda** | **98-0691007** |
| **(State or other jurisdiction of incorporation or organization)** | **(I.R.S. Employer Identification No.)** |

**7665 Corporate Center Drive, Miami, Florida 33126**

**(Address of principal executive offices) (zip code)**

**(305) 436-4000**

**(Registrant's telephone number, including area code)**

**N/A**

**(Former name, former address and former fiscal year, if changed since last report)**

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company (See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act).

| | |
|---|---|
| Large accelerated filer x | Accelerated filer ¨ |
| Non-accelerated filer ¨ (Do not check if a smaller reporting company) | Smaller reporting company ¨ |

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No x

There were 229,147,263 ordinary shares outstanding as of July 31, 2015.

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**PART I. FINANCIAL INFORMATION**

**Item 1. Financial Statements**

**Norwegian Cruise Line Holdings Ltd.**

**Consolidated Statements of Operations**

**(Unaudited)**

**(in thousands, except share and per share data)**

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| | 2015 | 2014 | 2015 | 2014 |
| Revenue | | | | |
| Passenger ticket | $787,991 | $528,782 | $1,458,474 | $977,362 |
| Onboard and other | 297,442 | 237,145 | 565,141 | 452,593 |
| Total revenue | 1,085,433 | 765,927 | 2,023,615 | 1,429,955 |
| Cruise operating expense | | | | |
| Commissions, transportation and other | 192,438 | 114,712 | 364,265 | 231,522 |
| Onboard and other | 67,885 | 55,467 | 126,530 | 103,391 |
| Payroll and related | 161,930 | 106,352 | 319,559 | 205,418 |
| Fuel | 91,581 | 77,832 | 178,955 | 156,872 |
| Food | 43,699 | 42,734 | 85,550 | 80,417 |
| Other | 98,746 | 73,699 | 205,120 | 139,086 |
| Total cruise operating expense | 656,279 | 470,796 | 1,279,979 | 916,706 |
| Other operating expense | | | | |
| Marketing, general and administrative | 107,164 | 83,084 | 261,321 | 166,473 |
| Depreciation and amortization | 104,607 | 63,459 | 204,583 | 125,099 |
| Total other operating expense | 211,771 | 146,543 | 465,904 | 291,572 |
| Operating income | 217,383 | 148,588 | 277,732 | 221,677 |
| Non-operating income (expense) | | | | |
| Interest expense, net | (52,446) | (31,860) | (103,435) | (63,032) |
| Other income (expense) | (3,717) | (325) | (33,856) | 63 |
| Total non-operating income (expense) | (56,163) | (32,185) | (137,291) | (62,969) |
| Net income before income taxes | 161,220 | 116,403 | 140,441 | 158,708 |
| Income tax benefit (expense) | (2,726) | (3,124) | (3,403) | 6,263 |
| Net income | 158,494 | 113,279 | 137,038 | 164,971 |
| Net income attributable to non-controlling interest | — | 1,663 | — | 2,088 |
| Net income attributable to Norwegian Cruise Line Holdings Ltd. | $158,494 | $111,616 | $137,038 | $162,883 |

| | | | | |
|---|---|---|---|---|
| Weighted-average shares outstanding | | | | |
| Basic | 225,698,078 | 204,965,718 | 225,003,460 | 205,063,870 |
| Diluted | 230,228,144 | 210,472,991 | 229,664,210 | 210,742,655 |
| Earnings per share | | | | |
| Basic | $0.70 | $0.54 | $0.61 | $0.79 |
| Diluted | $0.69 | $0.54 | $0.60 | $0.78 |

The accompanying notes are an integral part of these consolidated financial statements.

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**Norwegian Cruise Line Holdings Ltd.**

**Consolidated Statements of Comprehensive Income**

**(Unaudited)**

**(in thousands)**

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| | **2015** | **2014** | **2015** | **2014** |
| Net income | $ 158,494 | $ 113,279 | $ 137,038 | $ 164,971 |
| Other comprehensive income (loss): | | | | |
| Shipboard Retirement Plan | 120 | 95 | 239 | 189 |
| Cash flow hedges: | | | | |
| Net unrealized income (loss) | 70,491 | 8,797 | (33,274 ) | (6,559 ) |
| Amount realized and reclassified into earnings | 26,564 | (147 ) | 48,450 | 6 |
| Total other comprehensive income (loss) | 97,175 | 8,745 | 15,415 | (6,364 ) |
| Total comprehensive income | 255,669 | 122,024 | 152,453 | 158,607 |
| Comprehensive income attributable to non-controlling interest | — | 1,757 | — | 2,045 |
| Total comprehensive income attributable to Norwegian Cruise Line Holdings Ltd. | $ 255,669 | $ 120,267 | $ 152,453 | $ 156,562 |

The accompanying notes are an integral part of these consolidated financial statements.

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**Norwegian Cruise Line Holdings Ltd.**

**Consolidated Balance Sheets**

**(Unaudited)**

**(in thousands, except share data)**

| | June 30, 2015 | December 31, 2014 |
|---|---|---|
| **Assets** | | |
| Current assets: | | |
| Cash and cash equivalents | $172,958 | $84,824 |
| Accounts receivable, net | 36,801 | 32,432 |
| Inventories | 59,801 | 56,555 |
| Prepaid expenses and other assets | 130,357 | 109,924 |
| Total current assets | 399,917 | 283,735 |
| Property and equipment, net | 8,674,815 | 8,623,773 |
| Goodwill | 1,388,931 | 1,388,931 |
| Intangible assets | 958,394 | 994,997 |
| Other long-term assets | 265,330 | 281,641 |
| Total assets | $11,687,387 | $11,573,077 |
| **Liabilities and Shareholders' Equity** | | |
| Current liabilities: | | |
| Current portion of long-term debt | $585,875 | $576,947 |
| Accounts payable | 55,061 | 101,983 |
| Accrued expenses and other liabilities | 581,216 | 552,514 |
| Due to Affiliate | 38,737 | 37,948 |
| Advance ticket sales | 1,213,199 | 817,207 |
| Total current liabilities | 2,474,088 | 2,086,599 |
| Long-term debt | 5,178,044 | 5,607,157 |
| Due to Affiliate | — | 18,544 |
| Other long-term liabilities | 294,800 | 341,964 |
| Total liabilities | 7,946,932 | 8,054,264 |
| Commitments and contingencies (Note 9) | | |
| Shareholders' equity: | | |
| Ordinary shares, $.001 par value; 490,000,000 shares authorized; 232,281,275 shares issued and 229,128,505 shares outstanding at June 30, 2015 and 230,116,780 shares issued and 227,630,430 shares outstanding at December 31, 2014 | 232 | 230 |
| Additional paid-in capital | 3,771,531 | 3,702,344 |
| Accumulated other comprehensive income (loss) | (227,227) | (242,642) |
| Retained earnings | 277,919 | 140,881 |
| Treasury shares (3,152,770 and 2,486,350 ordinary shares at June 30, 2015 and December 31, 2014, respectively, at cost) | (82,000) | (82,000) |
| Total shareholders' equity | 3,740,455 | 3,518,813 |
| Total liabilities and shareholders' equity | $11,687,387 | $11,573,077 |

The accompanying notes are an integral part of these consolidated financial statements.

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**Norwegian Cruise Line Holdings Ltd.**

**Consolidated Statements of Cash Flows**

**(Unaudited)**

**(in thousands)**

| | Six Months Ended June 30, 2015 | 2014 |
|---|---|---|
| **Cash flows from operating activities** | | |
| Net income | $137,038 | $164,971 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization expense | 214,717 | 141,228 |
| Loss (gain) on derivatives | 27,475 | (62) |
| Deferred income taxes, net | 424 | 2,786 |
| Contingent consideration | (43,400) | — |
| Write-off of deferred financing fees | 195 | — |
| Share-based compensation expense | 14,166 | 5,079 |
| Changes in operating assets and liabilities: | | |
| Accounts receivable, net | (4,369) | (8,885) |
| Inventories | (3,246) | (8,851) |
| Prepaid expenses and other assets | (15,472) | (8,943) |
| Accounts payable | (47,038) | 15,967 |
| Accrued expenses and other liabilities | (949) | 20,905 |
| Advance ticket sales | 412,602 | 194,913 |
| Net cash provided by operating activities | 692,143 | 519,108 |
| **Cash flows from investing activities** | | |
| Additions to property and equipment | (186,504) | (787,566) |
| Net cash used in investing activities | (186,504) | (787,566) |
| **Cash flows from financing activities** | | |
| Repayments of long-term debt | (791,403) | (540,237) |
| Repayments to Affiliate | (18,522) | (18,521) |
| Proceeds from long-term debt | 340,060 | 914,545 |
| Proceeds from the exercise of share options | 55,023 | 2,158 |
| Purchases of treasury shares | — | (79,155) |
| NCLC partnership tax distributions | — | (3,115) |
| Deferred financing fees and other | (2,663) | (201) |
| Net cash provided by (used in) financing activities | (417,505) | 275,474 |
| Net increase in cash and cash equivalents | 88,134 | 7,016 |
| Cash and cash equivalents at beginning of period | 84,824 | 56,467 |
| Cash and cash equivalents at end of period | $172,958 | $63,483 |

The accompanying notes are an integral part of these consolidated financial statements.

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**Norwegian Cruise Line Holdings Ltd.**

**Consolidated Statements of Changes in Shareholders' Equity**

**(Unaudited)**

**(in thousands)**

| | Ordinary Shares | Additional Paid-in Capital | Accumulated Other Comprehensive Income (Loss) | Retained Earnings (Deficit) | Treasury Shares | Non-controlling Interest | Total Shareholders' Equity |
|---|---|---|---|---|---|---|---|
| **Balance, December 31, 2013** | $ 205 | $ 2,822,864 | $ (16,690) | $ (197,471) | $ — | $ 22,358 | $ 2,631,266 |
| Share-based compensation | — | 5,079 | — | — | — | — | 5,079 |
| Transactions with Affiliates, net | — | (59) | — | — | — | — | (59) |
| NCLC partnership tax distributions | | | | | | (3,115) | (3,115) |
| Proceeds from the exercise of share options | — | 2,158 | — | — | — | — | 2,158 |
| Purchases of treasury shares | | | | | (79,155) | | (79,155) |
| Other comprehensive loss | — | — | (6,321) | — | — | (43) | (6,364) |
| Net income | — | — | — | 162,883 | — | 2,088 | 164,971 |
| Transfers to non-controlling interest | — | (7,834) | — | — | — | 7,834 | — |
| **Balance, June 30, 2014** | $ 205 | $ 2,822,208 | $ (23,011) | $ (34,588) | $ (79,155) | $ 29,122 | $ 2,714,781 |
| | | | | | | | |
| **Balance, December 31, 2014** | $ 230 | $ 3,702,344 | $ (242,642) | $ 140,881 | $ (82,000) | $ — | $ 3,518,813 |
| Share-based compensation | — | 14,166 | — | — | — | — | 14,166 |
| Proceeds from the exercise of share options | 2 | 55,021 | — | — | — | — | 55,023 |
| Other comprehensive income | — | — | 15,415 | — | — | — | 15,415 |
| Net income | — | — | — | 137,038 | — | — | 137,038 |
| **Balance, June 30, 2015** | $ 232 | $ 3,771,531 | $ (227,227) | $ 277,919 | $ (82,000) | $ — | $ 3,740,455 |

The accompanying notes are an integral part of these consolidated financial statements.

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**Norwegian Cruise Line Holdings Ltd.**

**Notes to Consolidated Financial Statements**

**(Unaudited)**

*Unless otherwise indicated or the context otherwise requires, references in this report to (i) the "Company," "we," "our" and "us" refer to NCLH (as defined below) and its subsidiaries (including Prestige (as defined below), except for periods prior to the consummation of the Acquisition of Prestige (as defined below)), (ii) "NCLC" refers to NCL Corporation Ltd., (iii) "NCLH" refers to Norwegian Cruise Line Holdings Ltd., (iv) "Norwegian" refers to the Norwegian Cruise Line brand and its predecessors, (v) "Prestige" refers to Prestige Cruises International, Inc., together with its consolidated subsidiaries, (vi) "PCH" refers to Prestige Cruise Holdings, Inc., Prestige's direct wholly owned subsidiary, which in turn is the parent of Oceania Cruises, Inc. ("Oceania") and Seven Seas Cruises S. DE R.L. ("Regent") (Oceania also refers to the brand Oceania Cruises and Regent also refers to the brand Regent Seven Seas Cruises), (vii) "Apollo" refers to Apollo Global Management, LLC, its subsidiaries and the affiliated funds it manages and the "Apollo Holders" refers to one or more of AIF VI NCL (AIV), L.P., AIF VI NCL (AIV II), L.P., AIF VI NCL (AIV III), L.P., AIF VI NCL (AIV IV), L.P., AAA Guarantor — Co-Invest VI (B), L.P., Apollo Overseas Partners (Delaware) VI, L.P., Apollo Overseas Partners (Delaware 892) VI, L.P., Apollo Overseas Partners VI, L.P., Apollo Overseas Partners (Germany) VI, L.P., AAA Guarantor — Co-Invest VII, L.P., AIF VI Euro Holdings, L.P., AIF VII Euro Holdings, L.P., Apollo Alternative Assets, L.P., Apollo Management VI, L.P. and Apollo Management VII, L.P., (viii) "TPG Global" refers to TPG Global, LLC, "TPG" refers to TPG Global and its affiliates and the "TPG Viking Funds" refers to one or more of TPG Viking, L.P., TPG Viking AIV I, L.P., TPG Viking AIV II, L.P., and TPG Viking AIV-III, L.P. and/or certain other affiliated investment funds, each an affiliate of TPG, (ix) "Genting HK" refers to Genting Hong Kong Limited and/or its affiliates (formerly Star Cruises Limited and/or its affiliates) (Genting HK owns NCLH's ordinary shares indirectly through Star NCLC Holdings Ltd., its wholly owned subsidiary ("Star NCLC")), and (x) "Affiliate(s)" or "Sponsor(s)" refers to the Apollo Holders, Genting HK and/or the TPG Viking Funds.*

**1. Corporate Reorganization**

In February 2011, NCLH, a Bermuda limited company, was formed with the issuance to the Sponsors of, in aggregate, 10,000 ordinary shares, with a par value of $.001 per share. On January 24, 2013, NCLH consummated its initial public offering ("IPO"). In connection with the consummation of the IPO, the Sponsors' ordinary shares in NCLC were exchanged for the ordinary shares of NCLH at a share exchange ratio of 1.0 to 8.42565 and NCLH became the owner of 100% of the ordinary shares and parent company of NCLC (the "Corporate Reorganization"). Accordingly, NCLH contributed $460.0 million to NCLC and the historical financial statements of NCLC became those of NCLH. The Corporate Reorganization was effected solely for the purpose of reorganizing our corporate structure. NCLH had not prior to the completion of the Corporate Reorganization conducted any activities other than those incidental to its formation and to preparations for the Corporate Reorganization and IPO. The Corporate Reorganization resulted in all parties being in the same economic position as they were immediately prior to the IPO. As the economic position of the investors did not change as part of the Corporate Reorganization it is considered a nonsubstantive merger from an accounting perspective.

As a result of the Corporate Reorganization, NCLC was treated as a partnership for U.S. federal income tax purposes, and the terms of the partnership (including the economic rights with respect thereto) are set forth in an amended and restated tax agreement for NCLC. Economic interests in NCLC were represented by the partnership interests established under the tax agreement, which we refer to as "NCL Corporation Units." The NCL Corporation Units held by NCLH (as a result of its ownership of 100% of the ordinary shares of NCLC) represented a 97.3% economic interest in NCLC as of the consummation of the IPO. The remaining 2.7% economic interest in NCLC as of the consummation of the IPO was in the form of Management NCL Corporation Units held by management (or former management).

In the fourth quarter of 2014, all Management NCL Corporation Units were exchanged for NCLH ordinary shares and restricted ordinary shares. NCLH became the sole member and 100% owner of the economic interests in NCLC and the non-controlling interest no longer exists. Accordingly, NCLC is now treated as a disregarded entity for U.S. federal income tax purposes. No new NCLC profits interests or Management NCL Corporation Units will be issued; however, NCLH has granted, and expects to continue to grant to our management team, options to acquire its ordinary shares under its long-term incentive plan.

## 2. Summary of Significant Accounting Policies

### Basis of Presentation

The accompanying consolidated financial statements are unaudited and, in our opinion, contain all normal recurring adjustments necessary for a fair statement of the results for the periods presented.

Our operations are seasonal and results for interim periods are not necessarily indicative of the results for the entire fiscal year. Historically, demand for cruises has been strongest during the summer months. The interim consolidated financial statements should be read in conjunction with the audited consolidated financial statements for the year ended December 31, 2014, which are included in our most recently filed Annual Report on Form 10-K.

During the three months ended June 30, 2015, we revised for the year ended December 31, 2014, the classification of goodwill and intangible assets to separately present goodwill and intangible assets, net. The revision was not deemed material to the Consolidated Balance Sheet.

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**Reclassification**

Certain amounts in prior periods have been reclassified to conform to the current period presentation.

**Shareholders' Equity**

In connection with the Corporate Reorganization, previously granted profits interests to employees were exchanged for Management NCL Corporation Units ("Units"), and the vested Unit holders gained proportionate rights to distributions of NCLC and were therefore allocated a proportionate share of NCLC's equity. The effect of this change was a $20.2 million increase in the non-controlling interest.

During the six months ended June 30, 2014, following the effectiveness of NCLH's registration statement on Form S-3, additional performance-based Units became eligible to participate in the earnings of NCLC, and as a result, a proportionate amount of NCLC's equity was allocated to the additional non-controlling interest. Each Unit holder had the right, subject to the same time-based and performance-based vesting requirements of the profits interests, to exchange Units for NCLH's ordinary shares at a rate equal to one ordinary share for every Unit. When such an exchange occurred, this resulted in the exchange of non-controlling interest to controlling interest. Accordingly, upon the exchange of a Unit for an ordinary share of NCLH, a portion of the non-controlling interest balance was reclassified to additional paid-in capital. As of June 30, 2014, there was $7.8 million transferred to non-controlling interest.

As of June 30, 2014, Management NCL Corporation Unit holders were distributed cash to facilitate partnership tax payments of $3.1 million and $2.8 million of these distributions were subsequently repaid to NCLC upon exchange of each Unit holders' Units. In the fourth quarter of 2014, all Management NCL Corporation Units were exchanged for NCLH ordinary shares and restricted ordinary shares. We refer you to Note 1— "Corporate Reorganization".

On April 29, 2014, NCLH's Board of Directors authorized, and NCLH announced, a three-year share repurchase program for up to $500.0 million. NCLH may make repurchases in the open market, in privately negotiated transactions, in accelerated repurchase programs or in structured share repurchase programs, and any repurchases may be made pursuant to Rule 10b5-1 plans. During the three months ended June 30, 2014, NCLH repurchased approximately 2.4 million ordinary shares under its share repurchase program for $79.2 million, which shares are reflected as treasury shares at cost on the consolidated balance sheet as of June 30, 2014 included in NCLH's Quarterly Report on Form 10-Q filed on July 31, 2014. There was no share repurchase activity during the three and six months ended June 30, 2015, and as of June 30, 2015, $418.0 million remained available for repurchases of our outstanding ordinary shares under the share repurchase program. The increase in treasury shares reported in NCLH's consolidated balance sheets as of June 30, 2015 relates to certain forfeitures of restricted ordinary shares held by management or former management of NCLH.

**Earnings Per Share**

A reconciliation between basic and diluted earnings per share was as follows (in thousands, except share and per share data):

| | **Three Months Ended June 30,** | | Six Months Ended June 30, | |
|---|---|---|---|---|
| | **2015** | **2014** | **2015** | **2014** |
| Net income attributable to Norwegian Cruise Line Holdings Ltd. | $158,494 | $111,616 | $137,038 | $162,883 |
| Net income | $158,494 | $113,279 | $137,038 | $164,971 |
| Basic weighted-average shares outstanding | 225,698,078 | 204,965,718 | 225,003,460 | 205,063,870 |
| Dilutive effect of share awards | 4,530,066 | 5,507,273 | 4,660,750 | 5,678,785 |
| Diluted weighted-average shares outstanding | 230,228,144 | 210,472,991 | 229,664,210 | 210,742,655 |
| Basic earnings per share | $0.70 | $0.54 | $0.61 | $0.79 |
| Diluted earnings per share | $0.69 | $0.54 | $0.60 | $0.78 |

**Revenue and Expense Recognition**

Revenue and expense includes taxes assessed by governmental authorities that are directly imposed on a revenue-producing transaction between a seller and a customer. The amounts included in revenue and expense on a gross basis were $62.4 million and

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$44.6 million for the three months ended June 30, 2015 and 2014, respectively, and $114.3 million and $82.5 million for the six months ended June 30, 2015 and 2014, respectively.

Guest cancellation penalties are recognized in passenger ticket revenue at the time of the cancellation.

**Recently Issued Accounting Pronouncements**

In May 2014, the Financial Accounting Standards Board ("FASB") issued ASU No. 2014-09, "Revenue from Contracts with Customers." ASU No. 2014-09 requires entities to recognize revenue through the application of a five-step model, which includes identification of the contract, identification of the performance obligations, determination of the transaction price, allocation of the transaction price to the performance obligation and recognition of revenue as the entity satisfies the performance obligations. Entities have the option of using either a full retrospective or a modified approach to adopt the guidance. The FASB approved a one-year deferral of the effective date. We can elect to adopt the provisions of ASU No. 2014-09 for annual periods beginning after December 15, 2017 including interim periods within that reporting period or we can elect to early adopt the guidance as of the original effective date. We are currently evaluating the impact of the adoption of this newly issued guidance to our consolidated financial statements.

In April 2015, the FASB issued ASU No. 2015-03 which was issued to simplify the presentation of debt issuance costs. The guidance requires that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. The recognition and measurement guidance for debt issuance costs are not affected by these amendments. This guidance should be applied on a retrospective basis, wherein the balance sheet of each individual period presented should be adjusted to reflect the period-specific effects of applying the new guidance. The guidance will be effective for financial statements issued for fiscal years beginning after December 15, 2015, and interim periods within those fiscal years. Early adoption is permitted for financial statements that have not been previously issued. We are currently evaluating the impact of the adoption of this newly issued guidance to our consolidated financial statements.

In April 2015, the FASB issued ASU No. 2015-05 which was issued to clarify a customer's accounting for fees paid in a cloud computing arrangement. The amendments provide guidance to customers about whether a cloud computing arrangement includes a software license or if the arrangement should be accounted for as a service contract. This guidance will impact the accounting of software licenses but will not change a customer's accounting for service contracts. The guidance will be effective for annual periods, including interim periods within those annual periods, beginning after December 15, 2015. Early adoption is permitted. An entity can elect to adopt the amendments either prospectively or retrospectively. We are currently evaluating the impact, if any, of the adoption of this newly issued guidance to our consolidated financial statements.

**3. The Acquisition of Prestige**

On November 19, 2014, we completed the Acquisition of Prestige. Consideration for the Acquisition of Prestige includes a cash payment of up to $50 million upon achievement of certain 2015 net revenue milestones. The contingent consideration is valued using various projected 2015 net revenue scenarios weighted by the likelihood of each scenario occurring. The probability-weighted payout is then discounted at an appropriate discount rate commensurate for the risk of meeting the probabilistic cash flows. As the fair value is measured based upon significant inputs that are unobservable in the market, it was classified as Level 3 in the fair value hierarchy. Level 3 consists of significant unobservable inputs we believe market participants would use in pricing the asset or liability based on the best information available. The significant unobservable inputs used in the fair value measurement of the Company’s contingent consideration are the estimated annual net revenue and the probabilities associated with attaining the threshold and target net revenue as defined by the Merger Agreement. A significant increase in the estimated net revenue or an increase in the probability associated with reaching the target would result in a significantly higher fair value measurement. The maximum fair value would not be able to exceed $50 million, while an amount of net revenue less than 98% of target would result in no payout. For the six months ended June 30, 2015, the fair value of the contingent consideration was reduced to zero based upon updates to the probability-weighted assessment of various projected revenue scenarios. We do not believe that the net revenue target will be met, and accordingly, we recognized a $43.4 million fair value adjustment in the six months ended June 30, 2015, which was included in marketing, general and administrative expense.

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The following table summarizes the change in fair value of the contingent consideration liability (in thousands):

| | Contingent Consideration Liability |
|---|---|
| Balance as of December 31, 2014 | $ 43,400 |
| Fair value adjustment (Level 3) | (43,400) |
| Balance as of June 30, 2015 | $ — |

**4. Accumulated Other Comprehensive Income (Loss)**

Accumulated other comprehensive income (loss) for the six months ended June 30, 2015 was as follows (in thousands):

| | Accumulated Other Comprehensive Income (Loss) | Change Related to Cash Flow Hedges | Change Related to Shipboard Retirement Plan |
|---|---|---|---|
| Accumulated other comprehensive income (loss) at beginning of period | $ (242,642) | $ (234,188) | $ (8,454) |
| Current period other comprehensive loss before reclassifications | (33,274) | (33,274) | — |
| Amounts reclassified into earnings | 48,689 | 48,450 (1) | 239 (2) |
| Accumulated other comprehensive income (loss) at end of period | $ (227,227) | $ (219,012)(3) | $ (8,215) |

(1) We refer you to Note 7— "Fair Value Measurements and Derivatives" for the affected line items in the Consolidated Statements of Operations.
(2) Amortization of prior-service cost and actuarial loss reclassified to payroll and related expense.
(3) Includes $63.0 million of losses expected to be reclassified into earnings in the next 12 months.

Accumulated other comprehensive income (loss) for the six months ended June 30, 2014 was as follows (in thousands):

| | Accumulated Other Comprehensive Income (Loss) | Change Related to Cash Flow Hedges | Change Related to Shipboard Retirement Plan |
|---|---|---|---|
| | $ (16,690) | $ (10,532) | $ (6,158) |

| | | | | | | |
|---|---|---|---|---|---|---|
| Accumulated other comprehensive income (loss) at beginning of period | | | | | | |
| Current period other comprehensive loss before reclassifications | (6,515) | (6,515) | | — | | |
| Amounts reclassified into earnings | 194 | 6 | (1) | 188 | (2) |
| Accumulated other comprehensive income (loss) at end of period | $ (23,011) | $ (17,041) | | $ (5,970) | | |

(1) We refer you to Note 7— "Fair Value Measurements and Derivatives" for the affected line items in the Consolidated Statements of Operations.
(2) Amortization of prior-service cost and actuarial loss reclassified to payroll and related expense.

**5. Related Party Disclosures**

In May 2015, the Selling Shareholders sold 20,000,000 ordinary shares of NCLH in a Secondary Equity Offering. In March 2015, Genting HK and the TPG Viking Funds sold 12,500,000 ordinary shares of NCLH in a Secondary Equity Offering. The Company did not receive any proceeds from these offerings. As of June 30, 2015, the relative ownership percentages of NCLH's ordinary shares were as follows: Genting HK (17.7%), the Apollo Holders (20.6%), the TPG Viking Funds (3.2%), and public shareholders (58.5%).

In March 2015, we entered into an agreement with SWB Yankees, LLC related to sponsorship of and advertising with the Scranton/Wilkes-Barre RailRiders, a Minor League Baseball team. Pursuant to the agreement, we will pay an annual fee to SWB Yankees, LLC of $200,000. Mr. David M. Abrams, one of our directors, is the co-managing partner of the Scranton/Wilkes-Barre RailRiders.

**6. Income Tax Benefit (Expense)**

NCLH is treated as a corporation for U.S. federal income tax purposes. For the three months ended June 30, 2015, we had an income tax expense of $2.7 million compared to $3.1 million for the three months ended June 30, 2014. For the six months ended June 30, 2015 we had an income tax expense of $3.4 million compared to an income tax benefit of $6.3 million for the six months ended June 30, 2014. The benefit for 2014 includes a $6.7 million non-recurring benefit associated with the election of a tax method to calculate deductible interest expense.

## 7. Fair Value Measurements and Derivatives

Fair value is defined as the price at which an orderly transaction to sell an asset or to transfer a liability would take place between market participants at the measurement date under current market conditions (that is, an exit price at the measurement date from the perspective of a market participant that holds the asset or owes the liability).

### Fair Value Hierarchy

The following hierarchy for inputs used in measuring fair value should maximize the use of observable inputs and minimize the use of unobservable inputs by requiring that the most observable inputs be used when available:

| | |
|---|---|
| Level 1 | Quoted prices in active markets for identical assets or liabilities that are accessible at the measurement dates. |
| Level 2 | Significant other observable inputs that are used by market participants in pricing the asset or liability based on market data obtained from independent sources. |
| Level 3 | Significant unobservable inputs we believe market participants would use in pricing the asset or liability based on the best information available. |

### Derivatives

We are exposed to market risk attributable to changes in interest rates, foreign currency exchange rates and fuel prices. We attempt to minimize these risks through a combination of our normal operating and financing activities and through the use of derivatives. We assess whether derivatives used in hedging transactions are “highly effective” in offsetting changes in the cash flow of our hedged forecasted transactions. We use regression analysis for this hedge relationship and high effectiveness is achieved when a statistically valid relationship reflects a high degree of offset and correlation between the fair values of the derivative and the hedged forecasted transaction. Cash flows from the derivatives are classified in the same category as the cash flows from the underlying hedged transaction. The determination of ineffectiveness is based on the amount of dollar offset between the cumulative change in fair value of the derivative and the cumulative change in fair value of the hedged transaction at the end of the reporting period. If it is determined that a derivative is not highly effective as a hedge, or if the hedged forecasted transaction is no longer probable of occurring, then the amount recognized in accumulated other comprehensive income (loss) is released to earnings. In addition, the ineffective portion of our highly effective hedges is recognized in earnings immediately and reported in other income (expense) in our consolidated statements of operations. There are no amounts excluded from the assessment of hedge effectiveness and there are no credit-risk-related contingent features in our derivative agreements.

We monitor concentrations of credit risk associated with financial and other institutions with which we conduct significant business. Credit risk, including but not limited to counterparty non-performance under derivatives and our revolving credit facility, is not considered significant, as we primarily conduct business with large, well-established financial institutions that we have established relationships with and that have credit risks acceptable to us or the credit risk is spread out among a large number of creditors. We do not anticipate non-performance by any of our significant counterparties.

The following table sets forth our derivatives measured at fair value and discloses the balance sheet location (in thousands):

| | **Balance Sheet location** | **Asset June 30, 2015** | **December 31, 2014** | **Liability June 30, 2015** | **December 31, 2014** |
|---|---|---|---|---|---|
| Fuel swaps designated as hedging instruments | | | | | |
| | Accrued expenses and other liabilities | $1,744 | $ — | $52,407 | $ 111,304 |
| | Other long-term liabilities | 1,075 | 190 | 44,419 | 77,250 |
| Fuel swaps not designated as hedging instruments | | | | | |
| | Accrued expenses and other liabilities | — | — | 18,319 | — |
| Foreign currency forward contracts designated as hedging instruments | | | | | |
| | Prepaid expenses and other assets | 3,077 | — | — | — |
| | Other long-term assets | 1,730 | — | — | — |
| | Accrued expenses and other liabilities | — | — | 84,588 | 29,498 |
| | Other long-term liabilities | — | — | 11,330 | 118 |
| Foreign currency forward contracts not designated as hedging instruments | | | | | |
| | Prepaid expenses and other assets | 99 | — | — | — |
| Foreign currency collar not designated as a hedging instrument | | | | | |
| | Other long-term liabilities | — | — | 36,347 | 16,744 |
| Interest rate swaps designated as hedging instruments | | | | | |
| | Accrued expenses and other liabilities | — | — | 6,100 | 5,736 |
| | Other long-term liabilities | — | — | 4,114 | 3,104 |
| Interest rate swap not designated as a hedging instrument | | | | | |
| | Accrued expenses and other liabilities | — | — | — | 3,823 |

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The fair values of swap and forward contracts are determined based on inputs that are readily available in public markets or can be derived from information available in publicly quoted markets. The Company determines the value of options and collars utilizing an option pricing model based on inputs that are either readily available in public markets or can be derived from information available in publicly quoted markets. The option pricing model used by the Company is an industry standard model for valuing options and is used by the broker/dealer community. The inputs to this option pricing model are the option strike price, underlying price, risk free rate of interest, time to expiration, and volatility. The fair value of option contracts considers both the intrinsic value and any remaining time value associated with those derivatives that have not yet settled. The Company also considers counterparty credit risk and its own credit risk in its determination of all estimated fair values. Our derivatives and financial instruments were categorized as Level 2 in the fair value hierarchy, and we had no derivatives or financial instruments categorized as Level 1 or Level 3 as of June 30, 2015 and December 31, 2014.

Our derivative contracts include rights of offset with our counterparties. We have elected to net certain assets and liabilities within counterparties. We are not required to post cash collateral related to our derivative instruments. The following table discloses the amounts recognized within the consolidated balance sheets (in thousands):

| **June 30, 2015** | **Gross Amounts** | **Gross Amounts Offset** | **Total Net Amounts** | **Gross Amounts Not Offset** | **Net Amounts** |
|---|---|---|---|---|---|
| Assets | $ 4,906 | $ — | $ 4,906 | $ (4,906 ) | $ — |
| Liabilities | 257,624 | (2,819 ) | 254,805 | (142,479 ) | 112,326 |

| **December 31, 2014** | **Gross Amounts** | **Gross Amounts Offset** | **Total Net Amounts** | **Gross Amounts Not Offset** | **Net Amounts** |
|---|---|---|---|---|---|
| Liabilities | $ 247,577 | $ (190 ) | $ 247,387 | $ (59,023 ) | $ 188,364 |

***Fuel Swaps***

As of June 30, 2015, we had fuel swaps maturing through December 31, 2018 which are used to mitigate the financial impact of volatility in fuel prices pertaining to approximately 1.1 million metric tons of our projected fuel purchases.

The effects on the consolidated financial statements of the fuel swaps which were designated as cash flow hedges were as follows (in thousands):

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| | 2015 | 2014 | 2015 | 2014 |
| Gain recognized in other comprehensive income (loss) – effective portion | $ 34,133 | $ 11,610 | $ 31,332 | $ 1,839 |
| Gain (loss) recognized in other income (expense) – ineffective portion | (3,194 ) | 451 | (9,245 ) | 35 |
| Amount reclassified from accumulated other comprehensive income (loss) into fuel expense | 15,297 | (1,218 ) | 35,833 | (1,923 ) |

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As of June 30, 2015, we had fuel swaps pertaining to approximately 100,000 metric tons which were not designated as cash flow hedges. These fuel swaps were previously designated as cash flow hedges and were dedesignated due to a change in our expected future fuel purchases mix.

The effects on the consolidated financial statements of the fuel swaps which were dedesignated and immediately recognized into earnings were as follows (in thousands):

| | **Three Months Ended June 30,** | | **Six Months Ended June 30,** | |
|---|---|---|---|---|
| | **2015** | **2014** | **2015** | **2014** |
| Amount reclassified from accumulated other comprehensive income (loss) into other income (expense) | $ 10,000 | $ | | |